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Reforming International Investment Agreements

William Waren, Working Draft 04-22-09

Summary

I. The Problem with International Investment Agreements

NAFTA, other FTAs, and bilateral investment treaties (BITs) create open-ended property rights that investors can use to challenge a wide range of regulations adopted in the public interest, including regulations adopted in response to the current economic and financial crisis.

For example, given the current instability in the financial markets, the United States must be able to regulate financial services and to take other necessary emergency measures without exposing itself to attacks through investor-state arbitration.
International investment agreements grant foreign investors greater procedural rights, and they grant greater substantive rights.
Domestic implementing legislation for international investment agreements provides greater rights to the federal government than to U.S. state and local governments. Unfunded mandates and federal preemption of state and local laws may result.
International investment agreements should afford appropriate policy space for governments, free from the risk of a potentially catastrophic damages award, to enact general measures for a public purpose, so long as the measure does not specifically target a foreign investor for abusive or overtly discriminatory treatment.

II. Selected Options for Reforming International Investment Agreements and Domestic Implementing Legislation

First, officially interpret the investment chapters of NAFTA and other existing agreements with respect to:

- Investor rights to compensation for "expropriation."
- Investor rights to a "minimum standard of treatment".
- Investor rights that supersede multilateral environmental agreements.
- Investor rights to benefit of standing to bring an international investment claim.

Later enact more comprehensive reforms.

Options for substantive reform:

- State that the purpose of the investment provision, agreement, or treaty is to provide protection for small and medium sized investors, primarily by facilitating the resolution of their claims, and not to resolve issues of domestic constitutional law or to decide issues of public policy.

- Ensure that no international investment agreement permits challenges to U.S. regulation of financial services or emergency measures taken in response to a financial or economic crisis.
- Establish general exceptions.
- Narrow the definition of investment in existing U.S. investment agreements, which is extraordinarily broad, extending well beyond the concept of "property" protected by the "takings clause" in the U.S. Constitution.
- Limit provisions on expropriation and the minimum standard of treatment under international law, establishing that the adoption or application by any national or sub-national government of any bona fide and non-discriminatory measure intended to serve a public purpose shall not constitute a violation.
- Limit provisions on most-favored-nation treatment.

Options for procedural reform:

- Require that claims made against the United States must be based on a final government action.
- Establish a process of diplomatic review of investor claims by the party that is host to the investment.
- Establish a process for domestic judicial review of international investment tribunal awards.
- Establish a clean hands standard, so that investors may not go forward with an investment claim if they are shown to have made payments or provided a pecuniary advantage to public officials.
- Establish principles of deference to the reasonable decisions of domestic legislative, judicial, and administrative bodies that international tribunals must observe, so long as the foreign investor was not specifically targeted for discriminatory or harmful action.
- Deny benefit of standing to bring an investment claim against the United States to subsidiaries of U.S. corporations.
- Establish conflict of interest standards for the selection of arbitrators.

Options for reform of implementation process:

- Establish protections against federal preemption and unfunded federal mandates imposed on state and local governments as a result of international investment litigation.
- Require that Congress take specific action to appropriate monies to pay awards of financial damages by an international investment tribunal.

Reforming International Investment Agreements

I. The Problem with International Investment Agreements

During the campaign, President Obama stated, "I will ensure that foreign investor rights are strictly limited and will fully exempt any law or regulation written to protect public safety or promote the public interest. And I will never agree to granting foreign investors any rights in the U.S. greater than those of Americans. Our judicial system is strong and gives everyone conducting business in the United States recourse in our courts."[1]

The President was responding to the fact that NAFTA, other FTAs, and bilateral investment treaties (BITs) create open-ended property rights that investors can use to challenge a wide range of regulations adopted in the public interest, including regulations adopted in response to an economic or financial emergency.[2]

For example, given the current instability in the financial markets, the United States must be able to regulate financial services and to take other necessary emergency measures[3] without exposing itself to attacks through investor-state arbitration.[4]
International investment agreements allow foreign investors to file claims against national governments seeking money damages in compensation for public interest regulation at the national, state, or local level. Investors no longer have to work through trade ministries to pursue a claim. As a result, the volume of cases increases. Lacking a diplomatic screen, the claims may be brought without the restraint that nation-states exercise when dealing with issues of international relations. And, international investment tribunals can effectively enforce their decisions by ordering the national government to pay money damages to the foreign investor.

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1 Pennsylvania Fair Trade Coalition, 2008 Presidential Candidate Questionnaire, answer of Sen. Barak Obama, questions 10, available at http://www.citizenstrade.org/pdf/QuestionnairePennsylvaniaFairTradeCoalition040108FINAL_SenatorObamaResponse.pdf (viewed August 24, 2008); *see also* Barak Obama for President, *A Blueprint for Change*, Strengthening the economy: Trade, 13, available at http://www.barackobama.com/issues/ (viewed August 24, 2008).

2 The modern model for protecting foreign investments, embodied in NAFTA chapter 11, has its origins in the 1970s when the United States concluded bi-lateral investment treaties (BITS) with several developing countries. Among the distinguishing features of BITS are: (1) broad and largely undefined provisions for protecting the property rights of foreign investors, such as "indirect expropriation," (2) an investor-to-state dispute resolution mechanism, which provides standing for an individual foreign investor to invoke international arbitration against a nation-state, based on allegations that a governmental measure violates treaty provisions protecting foreign property rights, and (3) enforcement of international tribunal decisions with awards of money damages to foreign investors in compensation for such treaty violations. *See*, Matthew C. Porterfield. *International Expropriation Rules and Federalism*, Stanford Environmental Law Journal, Vol. 23, No. 1, January 2004, 36-39.

3 Other necessary emergency measures should include preserving the right for each such country to place restrictions on capital flows to reduce global financial instability and trade volatility.

4 Current U.S. practice with FTAs is to address financial services in a separate chapter, which incorporates by reference certain provisions of the agreement's investment and services chapters, including the provisions related to the availability of investor-state arbitration for alleged breaches of certain investment provisions. *See, e.g.*, United States Panama Trade Promotion Agreement, Article 12.1(2), [hereinafter U.S.-Panama TPA] *available at* http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Panama_FTA/Final_Text/asset_upload_file494_10346.pdf

By contrast, a reformed model for international investment agreements could ensure that governmental policies and actions adopted for a public purpose "will not attract liability." According to Gus Van Harten 5: "...NAFTA (and other investment treaties) should afford appropriate policy space for governments, free from the risk of a potentially catastrophic damages award, to enact general measures for a public purpose so long as the measure does not specifically target a foreign investor (or group of foreign investors) for abusive or overtly discriminatory treatment." 6

International investment agreements grant foreign investors greater procedural rights. President Obama stated that he "will never agree to granting foreign investors any rights in the U.S. greater than those of Americans." But, by its very nature international investor-state dispute resolution grants greater procedural rights to foreign corporations and investors than those enjoyed by Americans.

Arbitrators in these cases are typically international commercial lawyers who may alternately serve as arbitrators in one case and plaintiff's counsel in the next, thus raising questions of conflict of interest.

Arbitrators may have little or no familiarity with the constitution of the defendant country. In any case, arbitrators may apply international rules that supersede domestic constitutional principles in rendering an opinion.

Arbitrators make their decisions based on the text of an international investment agreement and customary international law, both of which are to be interpreted in light of the purpose of the agreement: to promote international investment. The agreements establish procedural rights for foreign investors to enforce agreements and to collect damages. Ordinary U.S. citizens enjoy no significant procedural or enforcement rights under the agreements, in part because the agreements impose very little in the way of foreign investor responsibilities. In other words, values of international commerce may trump other values, such as the appropriate role of government to regulate in the public interest and the need to strike a balance between the rights and responsibilities of transnational corporations.

International investment agreements grant foreign investors greater substantive rights. Among the substantive provisions in the current U.S. model investment chapter, embodied in the Chile, Singapore, and subsequent agreements, three stand out:

- the scope of the protected property interests under an overbroad definition of investment;
- the unresolved definition of when government regulation constitutes an indirect expropriation for which compensation must be provided; and
- the almost total lack of definition of what it means for a government to fail to meet the minimum standard of treatment of a foreign investor under international law.

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5 Osgoode Hall Law School, York University, Toronto.

6 Gus Van Harten, *Potential Reforms of the NAFTA Investment Regime*, March 2009, p. 2 (draft paper on file Forum on Democracy & Trade). Van Harten goes on to say, "This policy space should be at its broadest for legislatures, but should apply also to judicial decisions and generally-applicable measures of the executive. A reform goal should therefore be to establish a regime in which states can reliably conclude that a general measure that is pursued for a public purpose will not attract liability and in turn, will not encumber policy space or public budgets with risks of investor claims and state liability.

These three provisions stand out first because they grant rights to foreign investors, not found in U.S. constitutional jurisprudence, contrary to the President's stated position. In addition, they stand out because they appear to violate the instruction in section 2102(b)(3) of the Trade Act of 2002, requiring "that foreign investors are not accorded greater substantive rights with respect to investment protections than United States investors in the United States ... "

- *Overbroad definition of investment.* The current US model for international investment agreements contains a definition of investment that is broader than the constitutional standards used under domestic law in the U.S. Starting with the Chile and Singapore Free Trade Agreements, a new and complex definition of investment appears, one that seems to cover a range of economic interests at least as broad or broader than the interests covered under NAFTA chapter 11 (which itself was noted for its over-breadth compared to U.S. constitutional standards). For example, the definition includes enterprises or interest in the assets or profits of any enterprise. Any interests resulting in the commitment of capital also might be considered an investment.7 In addition, language in the expropriation annex refers broadly to "tangible and intangible" property rights and interests.8

- *Expropriation.* International investment tribunals are not in agreement on the scope of expropriation rules. In contrast to the narrow construction by U.S. courts of analogous property rights protections in the Fifth Amendment "takings" clause9, international arbitrators have room to read the vague expropriation language of international investment agreements broadly or narrowly. The arbitrators in *Methanex v. United States* interpreted NAFTA's expropriation rule narrowly, but the tribunal in the earlier case of *Pope & Talbott* gave the same language a broad construction.10 Accordingly, the

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7 By contrast, in the United States, the courts generally uphold takings claims only with respect to physical or intellectual property. Challenges to regulations of economic activity that do not affect a specific property interest, but rather only affect the profitability of an economic enterprise generally are reviewed under the deferential standard of substantive due process, which as a practical matter makes it almost impossible for the challenge to succeed so long as there is some conceivable rational basis for the regulatory policy.

8 *See, e.g.,* Appendix 10-B, U.S./Peru Free Trade Agreement.

9 U.S. constitutional case law construes the analogous Fifth Amendment Takings Clause narrowly. U.S. courts generally find that a government regulation amounts to a compensable "taking" of property only when the regulation eliminates all or substantially all of its economic value. *See Lucas* v. *South Carolina Coastal Council,* 505 U.S. 1003 at 1019 n.8,(1992) ("It is true that in at least some cases the landowner with 95% loss will get nothing, while the landowner with total loss will recover in full"). The Supreme Court has held that so long as it does not constitute a physical invasion of property, the "mere diminution in the value of property, however serious, is insufficient to demonstrate a taking." *See Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California,* 508 U.S. 602, 645 (1993).

10 The NAFTA tribunal decision in *Methanex v. United States* reads the rule relatively narrowly, concluding that:"as a matter of international law, a nondiscriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects...a foreign investor or investment is not deemed expropriatory or compensatory," unless specific commitments to refrain from regulation were made to the investor. *Methanex v. United States,* Final Award, part IV, chapter D, paragraph 7 (2005). In sharp contrast, the NAFTA panel in *Pope & Talbot* said economic regulation, even when it is an exercise of the state's traditional police powers, can be a prohibited indirect or "creeping" expropriation under customary international law if it is "substantial enough." *Pope & Talbot v. Canada,* Interim Award by Arbitral Tribunal, In the Matter of an Arbitration

outcome of future cases is unpredictable, and potentially provides greater rights to foreign investors than U.S. investors.

In an attempt to respond to criticism that expropriation articles in international investment agreements provide greater rights to foreign investors, the most recent U.S. investment agreements, such as the U.S./ Peru agreement at Annex 10-B, instruct investment tribunals to apply the so-called *Penn Central* factors to determine when a regulatory action is a compensable expropriation.[11]

This three-part test, derived from the U.S. Supreme Court's decision in *Penn Central Transportation Co. v. City of New York,*[12] attempts to encapsulate U.S. constitutional law for determining when a government action constitutes a compensable regulatory taking, thereby fulfilling the "no greater substantive rights" mandate in the 2002 Trade Act.

The U.S. constitutional doctrine of regulatory takings, however, is not that simple, straightforward, or so heavily weighted in favor of property rights. The U.S. Supreme Court did not intend for the *Penn Central* factors to be a test to be mechanically applied.[13] But, a mechanical application is suggested when the factors are recited in the expropriation annex out of the context of the whole of the *Penn Central* opinion and out of the context of the whole of U.S. regulatory taking doctrine, which provides considerable deference to government regulatory authority. In fact, successful regulatory takings claims in the United States are rare and exceptional. Perhaps the Supreme Court made the most progress in resolving the confusion surrounding U.S. regulatory takings doctrine in *Lingle v. Chevron USA*[14] where it stated that regulatory takings analysis must focus on government actions that are "functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain."[15] *Lingle,* in contrast to *Penn Central*, provides some doctrinal clarity.[16]

Under Chapter Eleven of The North American Free Trade Agreement Between Pope & Talbot Inc. and The Government of Canada (April 10, 2001), pp. 33-34, *available at* <<http://www.naftaclaims.com>>. *The Third Restatement of the Foreign Relations Law of the United States* strikes a similar note, saying that an action that "unreasonably interferes" with "effective enjoyment" of an alien's property amounts to an expropriation under international law. Restatement (Third) of the Foreign Relations Law of the United States §712, comment (g), *quoted at* 35 in *Pope & Talbot, supra* at note 135.

11 This involves an examination of (1)"the economic impact of the government action, although the fact that the action or series of actions by the Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;"(2) "the extent to which the government action interferes with distinct, reasonable investment backed expectations;" and (3) the "character of the government action."

12 438 U.S. 104 (1978).

13 As the Court noted in *Penn Central:* "[W]e have frequently observed that whether a particular restriction will be rendered invalid by the government's failure to pay for any losses proximately caused by it depends largely upon the particular circumstances [in that] case." *Id.* at 124.

14 125 S.Ct. 2074 (2005).

15 *Id.* at 2083.

16 John Echeverria explains the lack of clarity in *Penn Central* as follows: "In Penn Central Transportation Co. v. City of New York, the Supreme Court famously observed that it had been "unable to develop any 'set formula' for determining when 'justice and fairness' require" payment under the Takings Clause, and that it was therefore compelled to rely on "essentially ad hoc, factual inquiries." In an apparent effort to begin to give some content to regulatory takings analysis, the Court identified three factors with "particular significance" in a takings case: (1) the

- *Minimum standard of treatment.* Even if one assumes that future tribunals will follow the rule in *Methanex* with regard to expropriation, international investment agreements still provide more extensive protection of property rights and more extensive restrictions on government regulation in the public interest than the U.S. Constitution. This is because many or most expropriation claims can easily be reframed as minimum treatment claims. The obligation on parties to provide a minimum standard of treatment under international law is broadly stated and highly subjective. Except with respect to issues of procedural due process, it is difficult to predict when a tribunal may decide that a government action has "denied justice" or failed to provide "substantive due process."17

Domestic implementing legislation for international investment agreements provides greater rights to the federal government than to U.S. state and local governments. U.S. state and local governments, although consulted, have no direct right to represent themselves before these international investment tribunals when a state or local law is alleged to be in violation of the United States' international obligations, even in cases where the state/local policy conflicts with the interests of the federal government or the Administration's political position.18

"economic impact" of the government action, (2) the extent to which the action "interferes with distinct investment-backed expectations," and (3) the "character" of the action. Yet, over the following twenty-five years, the Court has provided little guidance on the meaning and proper application of these three factors, perpetuating the essentially ad hoc approach to takings analysis and contributing to the widespread view those regulatory takings is an especially confused field of law. The Court's failure to come to grips with the meaning of Penn Central is especially striking in view of the substantial progress the Court has made recently in resolving other questions about regulatory takings doctrine." 23 U.C.L.A. J. Envtl. L. 171 (2005).

17 The "minimum standard of treatment," which includes the right to "fair and equitable treatment" is a vague and evolving standard that permits foreign investors to challenge government actions on the grounds that they are either procedurally or substantively unfair. The "minimum standard of treatment," in its most sophisticated form in the U.S. agreements with Chile and Singapore, is understood as: (1) an obligation rooted in "customary international law" (CIL), rather than treaty law; and includes (2) an obligation not to "deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world." These vague concepts allow international investment tribunals considerable discretion and make it difficult to predict when a tribunal will find that "justice" has been denied. Discussions in the case law and the academic literature about what types of measures are prohibited by the "minimum standard of treatment" obligation openly acknowledge that the decisions of tribunals rather than state practice define the content of the norm. The literature is focused on how egregiously a government's conduct must offend the tribunal's sense of justice in order to violate the standard. For example, a NAFTA investment tribunal has characterized the minimum standard as follows: "[T]he question is whether...a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment. This is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities." Award Waste Management v. United Mexican States, Case No.ARB(AF)/00/03, para. 95, ICSID (W. Bank) (April 30, 2004), available at http://www.state.gov/document5s/organization/34643.pdf. The "minimum standard of treatment" also permits a more aggressive review of economic legislation. One line of tribunal decisions, for example, has indicated that the minimum standard of treatment imposes a duty on governments not to change regulatory standards that were in effect when a foreign investment was made. *See* Award Occidental Petroleum Exploration and Production Co. v. Ecuador, para. 191 (UNCITRAL Arb.) (2004).Under U.S. substantive due process analysis and presumably under due process principles embodied in other legal systems, governments are generally free to change regulatory standards in response to changed circumstances or priorities. Tribunals have also noted that the minimum standard of treatment is continuing to "evolve," suggesting that the scope of protection that it provides to foreign investors will continue to expand. *See* Award Mondev Int'l Ltd. V. United States, Case No. ARB(AF)/99/2, para. 116,ICSID (W. Bank) (Oct.11, 2002). In sum, the concept of minimum treatment remains open-ended. As a consequence, it gives international investment tribunals, which are not directly accountable to any democratic institution, extraordinary discretion and power.

The inability of states and localities to represent themselves is a particular concern because international investment tribunals can effectively enforce their decisions by ordering the federal government to pay money damages to the foreign investor.19 The federal government has refused, so far, to assure states and localities that it will not seek reimbursement of any monies paid from the U.S. Treasury to satisfy international tribunal judgments. Similarly, the federal government has declined to reimburse states for the substantial expenses incurred in helping the United States defend against international investment claims and in responding to tribunal demands in the discovery process to produce large volumes of records and documents. Most disturbing of all, the federal government is authorized to sue to preempt any state or local measure that is a violation of a tribunal decision or that is otherwise inconsistent with an executive-legislative investment agreement.20

II. Selected Options for Reforming International Investment Agreements and Domestic Implementing Legislation

First, officially interpret the investment chapters of NAFTA and other existing agreements. The NAFTA nations could use interpretive notes, as provided in chapter 11 of the existing agreement, to clarify problematic investment provisions. Similar provisions are available in other multilateral and bilateral agreements. Specifically, the Administration may want to consider the following options for interpretive notes:

- ***Investor rights to compensation for "expropriation."*** An interpretive note could codify a decision that the United States won, *Methanex v USA,* in which the panel interpreted investor rights narrowly so that expropriation rules do not allow "regulatory taking" claims to exceed the rights of U.S. investors.

- ***Investor rights to a "minimum standard of treatment" (MST).*** An interpretive note could codify the interpretation by State Department lawyers in a pending dispute, *Glamis*

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Challenges to state or local measures under international investment agreements can result in significant costs to states and localities who assign lawyers to assist the United States in defending against the claim and who perform the labor intensive work of producing volumes of documents, data, and other information in response to the plaintiffs' discover demands.

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NAFTA, chapter 11, art. 1135. Any award by a NAFTA investment tribunal will be automatically appropriated. Congress has created a "judgment fund," a standing appropriation to pay damages resulting from the judgments of the U.S. Court of Claims, federal district courts, and international tribunals. It is a permanent and indefinite appropriation similar to that available to pay interest on the national debt. Payment of a judgment is automatic. 31 U.S.C. §1304 (1997); *see* U.S. General Accounting Office, Office of the General Counsel, Principles of Federal Appropriations Law (Nov. 1994) (GAO/OGC-94-33).

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Nonetheless it must be kept in mind that even if the foreign investor is awarded damages, the NAFTA panel ruling does not automatically result in preemption of state or local law. Nor is there any right of action for private parties to enforce panel rulings in U.S. courts. 19 U.S.C. §3312(c); 19 U.S.C. §102(c). If state officials are unwilling to amend policies that are popular with the public, federal officials may simply leave the state policy in place, pay damages to the investor, and hope the issue never arises again as a NAFTA case. In the alternative, the federal government may seek to quietly resolve the issue. For example, federal officials acting behind the scenes might apply political or economic pressure on state officials to "voluntarily" bring state policy in line with the panel ruling. If the investor wins, the United States also has the option of suing to preempt the state law. Unlike private investors, the federal government can sue a state or locality at any time and seek the preemption of state or local measures that do not comply with NAFTA. *Id.* State law is in an inferior position to federal law under NAFTA. If a dispute resolution panel finds that a federal law violates NAFTA's investment chapter, an act of Congress is required to comply with the ruling. North American Free Trade Agreement Implementation Act, Title I, §102 (a), 19 U.S.C.§3312 (1993).

Gold v. USA. The U.S. position in that case is that MST should be limited to "full protection and security" and denial of justice where domestic courts (not legislatures) treat foreign investors in a way that is "notoriously unjust."21

- ***Investor rights that supersede multilateral environmental agreements (MEAs).*** Canada lost a dispute involving its authority to limit cross-border transfer of hazardous waste under the Basel Convention. An interpretive note could codify Canada's position that investor rights do not trump MEAs.

- ***Investor rights to benefit of standing to bring an international investment claim.*** An interpretive note could clarify that tribunals must defer to governments that are parties to an investment agreement with respect to the definition of vague terms in the agreement. In particular, the parties may want to clarify when vague terms create confusion about who is an investor with standing to bring a claim under the agreement.22

Later enact more comprehensive reforms. A trade promotion authority bill, trade agreement that includes investment provisions, an investment agreement, or an investment treaty might:

Options for substantive reform:

- **State that the purpose of the investment provision, agreement, or treaty is to provide protection for small and medium sized investors, primarily by facilitating the resolution of their claims, and not to resolve issues of domestic constitutional law or to decide issues of public policy.** The best argument for retaining investor-to-state arbitration is that small and medium size U.S. investors in the developing world are subject to the vagaries of arbitrary administrative acts and a lack of judicial due process, but do not have the economic and political heft to get their grievances heard by the highest levels of the host government and the U.S. government. Unfortunately, investor-to-state claims have been used to raise instead major issues of constitutional law and public policy.

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21 Counter-Memorial of Respondent United States, Glamis Gold v. United States, September 19, 2006, available at: http://www.state.gov/documents/organization/73686.pdf (At page 221, the U.S. argues that minimum standard of treatment has essentially three components:(1) "full protection and security"; (2) a prohibition on "notoriously unjust" or "egregious", etc., behavior , and (3) a prohibition on uncompensated expropriation (but notes that this obligation is redundant because it is made explicit elsewhere). Conversely, the U.S. rejects the Glamis contention that minimum standard of treatment prohibits either (1) "arbitrary" conduct (pp. 227 et. seq.), or (2) conduct that upsets investors' expectations (pp. 230 et seq.).)

22 According to Gus Van Harten, *supra*, pp.3-4: " For example, the Free Trade Commission [the three NAFTA parties] could clarify that foreign investors who are minority shareholders of a domestic firm in the respondent state may bring NAFTA claims only with respect to their shareholder interest and not with respect to interests of the domestic firm as a whole. Both the U.S. (as the home state of the investor) and Mexico (respondent state) adopted this position in the litigation of the *GAMI* claim against Mexico. However the *GAMI* tribunal declined to accept these submissions in preference for a broad reading of NAFTA Article 1116 that apparently would allow minority shareholders to advance claims beyond the shareholder interest (*GAMI* 2004, para. 29-33). On this and other issues, the NAFTA states could provide clarification and, in terms of the interpretive process, could provide expressly that tribunals should defer to concurrent submissions of the NAFTA states in specific arbitrations."

- **Ensure that no international investment agreement permits challenges to U.S. regulation of financial services or emergency measures taken in response to a financial or economic crisis.** Although existing U.S. investment agreements contain an exception that purports to preserve the right of governments to take "prudential" measures to protect investors or the stability of the financial system,23 these exceptions contain a significant loophole. The prudential measures exceptions typically state that where regulations do not comply with other provisions of the agreement, "they shall not be used as a means of avoiding the Party's commitments" under the agreement.24 Thus the prudential measures exception appears to be tautological – a measure is permissible so long as it does not violate the agreement. *Credit Sarah, Kevin etc …explain need for reform of capital control restrictions in this section or a separate section.*

The danger of investor challenges to U.S. regulation of financial institutions and related emergency economic measures could be mitigated by carving out of the agreement financial services regulation and other necessary measures taken in response to an economic crisis. And if all else fails, provision could be made for a prudential measures exception similar to that contained in NAFTA, which does not contain the loophole language.25

- **Establish general exceptions.** A starting point would be to include general exceptions of the kind provided in GATT and other WTO agreements. A sampling of these includes:
  - protection of public morals;
  - preservation of public order and fundamental interests of society;
  - protection of human and animal health and life;
  - protection of consumers and workers; and
  - conservation of exhaustible resources and control of access to domestic resources that are in short supply.
- **Define investments covered by the investment provision, investment agreement, or investment treaty to exclude:**
  - commercial contracts and concessions, public debt and public debt instruments;
  - expectations of future profits;
  - government licenses and permits;
  - market share;
  - a loan to a government or government enterprise;
  - a bank letter of credit; or
  - the extension of credit in connection with a commercial transaction, such as trade

23 *See, e.g.,*U.S.-Panama TPA, art. 12.10(1); United States Model Bilateral Investment Treaty, art. 20(1), 2004 [hereinafter U.S. model BIT], *available at* http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf

24 *Id.* U.S. trade and investment agreements typically establish elaborate processes to determine the prudent measures exception's applicability. Under the U.S. model BIT, should a respondent invoke the provision during investor-state arbitration, the competent financial authorities of both state parties are to determine whether and to what extent it applies. However, in the event that these authorities cannot agree, the determination passes to the arbitral tribunal, just as it would have in the absence of such elaborate procedure. *See,* U.S. Model BIT, art. 20(3). Under an alternate scheme, the matter may be referred to a special financial services committee, and if the committee cannot decide, the matter passes into state-state arbitration upon the request of one of the Parties. If there is no such request, the question passes back to the investor-state arbitral panel. *See, e.g.,* U.S.-Panama TPA, art. 12.19, annex 12.16.1.

25 *See* North American Free Trade Agreement, *available at* http://www.sice.oas.org/trade/nafta/naftatce.asp, art. 1410(1): " Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: (a) the protection of investors, depositors, financial market participants, policyholders, policy claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider; (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers; and (c) ensuring the integrity and stability of a Party's financial system."

financing.[26]

- **Limit provisions on expropriation so as to:**
  - establish that the adoption or application by any national or sub-national government of any bona fide and non-discriminatory measure intended to serve a public purpose shall not constitute a violation of an expropriation article of an investment agreement or treaty;
  - require compensation only for measures that result in a permanent physical invasion of property, in the nationalization of an investment, the destruction of all economically viable use of property, or in the functional equivalent to the classic taking in which government directly appropriates private property or ousts the owner from its domain.[27]
  - prohibit compensation for regulatory or other measures that cause a mere diminution in the value, no matter how substantial, of the property or investment, unless the destruction of value is complete or so nearly complete as to constitute a direct expropriation or nationalization of the investment.
- **Limit provisions on minimum treatment, including any reference to concepts of fair and equitable treatment and full protection and security, to protection against:**
  - denial of procedural due process by courts, not legislatures, that results in a notorious injustice;
  - state-supported violence; and
  - discriminatory treatment with respect to measures adopted in response to an armed conflict, civil strife, or national emergency resulting in a requisitioning or destruction of an investment by a party's armed forces, police, or civil authorities, which is not required by the necessity of the situation.

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26 This language seeks to narrow the definition of investment in contrast to The definition of investment in existing U.S. investment agreements is extraordinarily broad, extending well beyond the concept of "property" protected by the "takings clause" in the U.S. Constitution, for example. Some international investment tribunals even seem to go so far as to extend the scope of the definition of investment to include expected future profits and market share.

27 In *Lingle v. Chevron USA*, 125 S.Ct. 2074 (2005), the U.S. Supreme Court stated that regulatory takings analysis must focus on government actions that are "functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain," Id. at 2083. That definition is further tightened by incorporating an expanded definition of the Methanex rule as suggested above, *i.e.,* "as a matter of international law, a nondiscriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects...a foreign investor or investment is not deemed expropriatory or compensatory," unless specific commitments to refrain from regulation were made to the investor. *Methanex v. United States*, Final Award, part IV, chapter D, paragraph 7 (2005).

- **Clarify that provisions on minimum treatment:**
  - if they include reference to concepts of fair and equitable treatment or full protection and security, do not thereby create additional investor rights;
  - are to be understood in the context of customary international law and do not incorporate by reference or implication provisions or concepts derived from World Trade Organization or other international trade and investment agreements; and
  - that any bona fide and non-discriminatory measure intended to serve a public purpose shall not constitute a violation of a minimum treatment article of an investment provision, agreement, or treaty.28
- **Limit provisions on most-favored-nation treatment:** to clarify that a party is not obliged to extend to investors of another party the benefit of any treatment, preference or privilege contained in any existing or future investment provision of a trade agreement, investment agreement, or investment treaty to which the investor's home state is not a party.

This clarifies that a party is not obliged under its most-favored-nation obligation to extend to investors of another party the preferences contained in another investment agreement. This clarification is a response to the holding in *Maffezini v. Spain,* which allowed provisions in a bilateral investment treaty with a third party (Chile) that were more favorable to the investor than provisions in the BIT between the investor's home country (Argentina) and Spain to be applied based on most-favored nation principles in the Argentina/Spain BIT. 29

Options for procedural reform:

- **Require that claims made against the United States under the trade agreement must be based on a final government action:** to clarify that they may be instituted only after an investor has exhausted all administrative and judicial remedies available under federal, state or local law in the United States, unless such remedies would be futile.

This recognizes that international investor-to-state arbitration is to be used as a last resort and should not be invoked routinely as a means of circumventing the domestic administrative and judicial processes. This also allows domestic courts and administrative bodies to resolve disputed facts and disputed points of domestic law prior to review by international arbitrators who have limited fact-finding capacity and even less competence to resolve disputes about domestic law.

- **Establish a process of diplomatic review of investor claims by the party that is host to the investment:**
  - to insure that no investor may proceed with a claim against the United States, where it has been determined by the U.S. Attorney General that it is contrary to the U.S. national interest or that the measure in question is a bona fide measure adopted in the public interest, rather than a measure that by its explicit terms or clear intent discriminates

28 These two sections clarify that the minimum treatment standard does not grant an investor a right to a stable and predictable regulatory environment, does not include a right to compensation on the grounds that a governmental measure frustrates an investor's expectations or reduces the profitability of an investment; and does not include substantive due process for economic rights. Sharply limiting the minimum treatment obligation may be necessary because its broad and undefined terms, in effect, allow investment tribunals to second guess governmental decisions based on subjective judgments of fundamental justice.

29 Decision on Jurisdiction in *Maffezini v. Spain* is available at:http://www.worldbank.org/icsid/cases/emilio_DecisiononJurisdiction.pdf *Cite & explain MTD v Chile also.*

against foreign investors; and 30

- to provide that if the U.S. Attorney General fails to decide whether the claim should proceed within a period of six months of referral, then the foreign investor may not submit its claim to arbitration.

- **Establish a process for domestic judicial review of international investment tribunal awards:**
  - by explicitly authorizing domestic courts to set aside international investment tribunal awards that are contrary to the public policy of the United States; and
  - specifying that it is contrary to the public policy of the United States for an international investment tribunal to award damages for a claim where the measure in question is a bona fide measure adopted in the public interest, rather than a measure that by its explicit terms or clear intent discriminates against foreign investors.31
- **Establish a clean hands standard for investors:** to ensure that no investor may proceed with a claim or be awarded damages, if the investor has directly or indirectly offered or given any undue pecuniary or other advantage to a public official of a host state for purposes of influencing any official decision or the performance of any public duty related to its investment claim.

This section in effect authorizes the abrogation of the rights of investors who seek to corrupt the legal and political processes of host states. Its terms are generally in line with U.N. and OECD conventions on bribery and corruption of foreign public officials in connection with international business transactions. *Credit Howard Mann & IISD...cite Tanzania water case*

- **Establish principles of deference to the reasonable decisions of domestic legislative, judicial, and administrative bodies that international tribunals must observe, so long as the foreign investor was not specifically targeted for discriminatory or harmful action.** Van Harten has suggested for example that international investment tribunals might be required "to defer to interpretations of domestic law arrived at by domestic courts or tribunals, and to presume that a conflict between a claimant and a respondent state over the meaning of domestic law should be interpreted in favor of the respondent state where the investor has not sought clarification from a domestic court or tribunal before initiating a...claim." **32**
- **Deny benefit of standing to bring an investment claim against the United States to subsidiaries of U.S. corporations.** As it now stands, international investment litigation against the United States by subsidiaries of U.S. corporations may be allowed. NAFTA article 1113 is unclear as to whether subsidiaries of U.S. corporations organized in Canada and Mexico and doing substantial business there may bring a NAFTA investment claim against the United States, thereby circumventing the U.S. court system. But, more recent investment agreements such as CAFTA article 10.12 on denial of benefit of standing would appear to deny standing only to subsidiaries of companies owned or controlled by persons from countries with whom the United States has either broken diplomatic relations or barred

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Similarly, no U.S. investor could proceed with a claim against another part to the agreement where a competent governmental authority, comparable to the U.S. Attorney General, has made a similar determination or has failed to act within a period of six months.

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Such provisions for domestic court review of awards would expand upon the rules of UNCITRAL, the United Nations convention on arbitration awards, which are codified at 9 U.S.C. §§201-208, and which explicitly authorize domestic courts to set aside international investment tribunal awards that are contrary to the public policy of the United States. In addition, it may necessary to amend these sections of the U.S. code to specify that it is contrary to the public policy of the United States for this no greater rights standard to be violated.

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Id.

commercial transactions.

- **Establish conflict of interest standards for the selection of arbitrators.** At the very least, U.S. negotiators might be asked to develop some standards related to conflict of interest, perhaps if only to require arbitrators to identify their private clients and disclose the potential interests of those clients in the arbitration.

Van Harten has suggested the need for more fundamental reform by establishing a free standing adjudicative body for investment claims that satisfies "standards of judicial independence so as to guard against apprehensions of bias in favor of investors and other interests..." or ""by providing more modestly for all ...adjudicators to be appointed to tribunals from a set roster of, for example, sitting domestic court judges who have been nominated to the roster by the states parties." "On this model," he says, "...adjudicators would carry with them the guarantees of independence they enjoy as domestic judges—including security of tenure, a guaranteed salary, a bar on outside remunerative activities, and an objective method of appointment ..." 33

Options for reform of implementation process:

- **Establish protections against federal preemption and unfunded federal mandates imposed on state and local governments as a result of international investment litigation:** by forbidding U.S. federal agencies from taking any of the following actions on grounds that a state, tribal, or local government law (or its application) is inconsistent with any bilateral or multilateral trade and investment agreement or investment treaty:
  - initiate legal action to preempt or invalidate a sub-national law or its enforcement or application;
  - shift costs, directly or indirectly, to a sub-national government that the United States must pay under an award for compensation to a foreign investor;
  - withhold funds or impose grant conditions on funds that a sub-national government would otherwise receive;
  - lobby or seek to influence a state sub-national government.

In addition, federal legislation could require that sub-national governments must be reimbursed for costs incurred in assisting the United States in defending against an international investment claim, including the cost of complying with a discovery order.

- **Require that Congress take specific action to appropriate monies to pay awards of financial damages by an international investment tribunal.** Currently, any award by an international investment tribunal will be automatically appropriated. Congress has created a "judgment fund," a standing appropriation to pay damages resulting from the judgments of the U.S. Court of Claims, federal district courts, and international tribunals. It is a permanent and indefinite appropriation similar to that available to pay interest on the national debt.34 Under the current system, there is no review by Congress of whether a tribunal award of money damages is contrary to the public policy of the United States. And, the payment from the judgment fund is automatic, even though there is no cap on the amount of money damages that might be awarded by a tribunal and even though plaintiffs have alleged damages in the past for as much as $1 billion. One remedy for these problems would be to scrap the system of making automatic payments from the judgment fund and provide for review of damage awards through the regular congressional appropriations process.

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33 *Id.* at 6.

34 31 U.S.C. §1304 (1997); *see* U.S. General Accounting Office, Office of the General Counsel, Principles of Federal Appropriations Law (Nov. 1994) (GAO/OGC-94-33).